EXPLANATORY MEMORANDUM TO

THE LOCAL AUDIT (PROFESSIONAL QUALIFICATIONS AND MAJOR LOCAL AUDIT) REGULATIONS 2014

2014 No. 1627

1. This explanatory memorandum has been prepared by the Department for Communities and Local Government and is laid before Parliament by Command of Her Majesty.

2. Purpose of the instrument

2.1 To define the minimum criteria a qualification will need to meet in order to be recognised for the purposes of local audit. The Local Audit and Accountability Act 2014 (the 2014 Act) sets out that auditors need to hold either a qualification recognised under Part 42 of the Companies Act 2006 or another qualification recognised under the 2014 Act and these regulations set out the minimum criteria under the 2014 Act.

2.2 To define the conditions for which relevant authorities would have their audits defined as 'major local audits', and therefore subject to an additional level of oversight by the Financial Reporting Council Ltd.

3. Matters of special interest to the Joint Committee on Statutory Instruments

None.

4. Legislative Context

4.1 The 2014 Act puts in place new arrangements relating to the accounts of local authorities and certain other public bodies in England (and a very limited category of authorities which exercise functions partly in England and partly in Wales) – defined as 'relevant authorities' including the appointment, functions and regulation of local auditors once the Audit Commission for Local Authorities and the National Health Service in England ("the Audit Commission") is abolished in 2015. For the bodies which are "relevant authorities" under the 2014 Act see section 2 of, and Schedule 2 to, that Act.

4.2 Part 4 of the 2014 Act is concerned with the eligibility and regulation of local auditors. It applies provisions in Part 42 of the Companies Act 2006 (statutory auditors) to audits of relevant authorities. Schedule 2 to the 2014 Act lists relevant authorities. Schedule 5 to the 2014 Act contains modifications to Part 42 of the Companies Act 2006 (the 2006 Act). Paragraphs 1 and 2 of Schedule 5 apply general modifications to the 2006 Act. Paragraphs 9 and 28(7) of Schedule 5 provide specific modifications to section 1219 of the 2006 Act (appropriate qualifications) and Schedule 10 to the 2006 Act (recognised supervisory bodies) which these Regulations are made under. The Government's intention is for the Financial Reporting Council Ltd to carry out the functions under these Regulations.

4.3 The provisions of the 2006 Act that apply with modifications include sections 1252 of that Act (delegation of the Secretary of State's functions) and 1253 (delegation of functions to an existing body) – see paragraphs 1, 2, 21 and 22 of Schedule 5 to the 2014 Act. The Local Audit (Delegation of Functions) and Statutory Audit (Delegation of Functions) Order 2014 ('the 2014 Order') delegates functions to the Financial Reporting Council Ltd, including functions of the Secretary of State under these Regulations. The 2014 Order has been laid in draft before Parliament under sections 1252(11) and 1290 of the Companies Act 2006 for approval by resolution of each House of Parliament. The Government intends to make this Order, subject to Parliamentary approval, shortly after these Regulations come into force.

4.4 These Regulations set out the minimum criteria that a qualification must meet to be recognised for the purpose of local audit. The Regulations also enable an additional level of oversight of the audits of bodies falling within the definitions specified in the Regulations. The intention is for these monitoring arrangements to be undertaken by the Financial Reporting Council. They mirror arrangements already in place for statutory i.e. company audits.

5. Territorial Extent and Application

This instrument applies to England and Wales.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 In August 2010 the Government announced its intention to disband the Audit Commission, transfer the work of its in–house practice to the private sector and put in place a new audit framework - in which relevant authorities would be able to appoint their own auditors from an open and competitive market, with a robust regulatory framework to ensure that high standards of audit were upheld.

7.2 To deliver these objectives, secondary legislation is needed to:

- set out the minimum criteria a qualification must meet in order to be recognised for the purposes of local audit;
- ensure that a public register of such local auditors is available; and
- set out which bodies will have their audits defined as 'major local audits' and therefore be subject to monitoring by the Financial Reporting Council.

7.3 During its passage through Parliament, the Bill received a total of 154 government amendments, many of them minor and technical, reflecting the level of prior scrutiny of the overall approach to eligibility and regulation of local auditors. The key concern in

relation to Part 4 of, and Schedule 5 to, the 2014 Act related to the wider scope of public audit and the qualification of auditors in the new framework.

7.4 These Regulations will give effect to two key elements of the new regulatory regime; setting out the minimum requirements a qualification must meet to be recognised for the purposes of local audit and defining which relevant authorities' audits will fall within the definition of a 'major local audit' and thus within the audit quality monitoring regime of the Financial Reporting Council. These arrangements closely reflect the regulatory arrangements set out in the Companies Act 2006 for statutory i.e. company audit.

8. Consultation outcome

8.1 Prior to the introduction of the 2014 Act into Parliament, the Government consulted twice, both on the broad policy approach and in more depth on the proposed new framework through publication of the draft Bill. During its passage through Parliament, Government provided draft regulations on several key provisions in the Bill to the Parliamentary Bill Committee and carried out an interactive public consultation exercise over 4 weeks from 25 November until 20 December. Over 130 responses to that consultation were received in total and 62 responses commented on the draft regulations associated with Appropriate Qualifications and Major Local Audit in Part 4 of and Schedule 5 to the Bill.

8.2 Nearly 80% of the responses received were in favour of the approach proposed in the regulations, which reflects the work that Government undertook prior to the public consultation in both having regard to the existing statutory framework and engaging with key stakeholders through a working group to ensure that the proposals reflected their views. 71% viewed the regulations as providing an appropriate framework to allow a body to develop a suitable qualification for local audit and 63% agreed that the proposed thresholds were appropriate to capture the audits of significant local bodies.

8.3 In relation to those respondents who disagreed with the conditions relating to major local audit, there was no single view. Some felt that, given the wider public interest in local bodies, all such bodies should be included within the definition, whilst others felt that the thresholds were too low or needed further refinement. The conditions defining a major local audit have been refined following consultation so that they are more easily understood. Some respondents queried the role of the Financial Reporting Council and the powers that would be delegated to it, although Government is of the view that these proposals are in line with its current oversight role and that therefore it is best placed to undertake a similar role in relation to local audit. However, the 2014 Order delegating these functions to the Financial Reporting Council has been amended to ensure that the Financial Reporting Council consults any bodies that would otherwise fall outside the conditions described, but that they wish to include in their monitoring arrangements.

9. Guidance

There is no accompanying guidance from the Secretary of State to this statutory instrument, however the intention is for the Financial Reporting Council to provide regulations under its delegated powers relating to its role and that of the recognised supervisory body in ensuring that they fulfil their duties in relation to ensuring the suitability of its members to carry out the audit of relevant local authorities and of providing a register of such members.

10. Impact

10.1 The impact on charities or voluntary bodies is nil; however there will be an impact on audit firms, with annualised costs per annum rising from around £1.04million to £2.18million. However this is offset by the opening up of the local public sector audit market to firms, enabling them to realise greater profits than in the baseline year and a decreased contribution to system costs (see Annex 3 of impact assessment for the 2014 Act).

10.2 The impact on the public sector in complying with the new audit arrangements in total is estimated to range from £2.98million per annum to £4.48million per annum, a best estimate of £3.73million per annum, which equates to roughly £4,800 per body per year in compliance costs (see Annex 2 of impact assessment for the 2014 Act).

10.3 An Impact Assessment was published alongside the introduction of the Local Audit and Accountability Bill to Parliament which provides an assessment of the overall cost and impact of the new regime. This can be accessed at the following address:- http://www.parliament.uk/documents/impact-assessments/IA13-11A.pdf.

11. Regulating small business

Whilst the legislation does not apply to small business in a wider sense there will be an impact on audit firms. The detailed costs and benefits are set out in Annex 3 of the impact assessment for the 2014 Act. However, whilst the new arrangements will result in an increased cost to audit firms, this is offset by the opening up of the local public sector audit market to a wider range of firms, enabling them to realise greater profits over the longer term, with a decreasing contribution to system costs over the current regime.

12. Monitoring & review

12.1 As part of the Government's commitment to review the implementation of new legislation within three to five years of receiving Royal Assent, Government has set out some general principles towards developing a possible approach to such a review and assessing the impacts/outcomes associated with the Government's reforms to local audit. An overriding objective for the final approach would be to ensure that any proposed measurement is both proportionate and cost effective.

12.2 The aims and success criteria of the local audit reforms are to:

- Deliver greater localism, decentralisation and transparency;
- Maintain competitive audit fees; and
- Uphold high standards of auditing.

The post implementation review will provide Government, Parliament and the public with the evidence to demonstrate that the local audit framework is achieving its anticipated outcomes and that the assumptions about costs and benefits identified are supported by the evidence.

13. Contact

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